Docket

BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 90-698-C - ORDER NO. 91-412

MAY 29, 1991

IN RE: Application of GTE South, Inc. for an Adjustment in Rates for Intrastate Telephone Service Furnished by it in the State of South Carolina.	ORDER APPROVING RATES AND CHARGES

I.

INTRODUCTION

This matter is before the Public Service Commission of South Carolina (the Commission) on the Application of GTE South, Inc. (GTE or the Company) for authority to change and/or increase certain rates and charges for intrastate telephone services provided to the public by the Company in the State of South Carolina. The Company's November 30, 1990, Application was filed pursuant to S.C. Code Ann.§58-9-520 (Supp. 1990) and S.C. Regulation 103-830, et. seq.

According to the Company's Application, its proposed rates and charges would have produced additional gross revenues of $10,695,955 had they been in effect for the twelve month period ending July 31, 1990. The Commission Staff agreed with this calculation. The Company's presently authorized rates and charges were approved by Order No. 85-200, dated March 27, 1985, in Docket

No. 84-390-C.

By letter dated December 11, 1990, the Commission's Executive Director instructed the Company to publish a prepared Notice of Filing and Hearing, once a week for two consecutive weeks, in newspapers of general circulation in the Company's affected service areas in South Carolina. The Notice of Filing indicated the nature of the Company's Application and advised all interested parties of the manner and time in which to file appropriate pleadings. The Company was likewise required to notify directly all customers affected by the proposed rates and charges. On February 8, 1991, the Company furnished affidavits demonstrating that the Notice of Filing and Hearing had been duly published in accordance with the instructions of the Executive Director. In addition, the Company certified that a copy of the Notice of Filing and Hearing had been mailed to each customer affected by the rates and charges proposed in the Company's Application.

Petitions to Intervene were filed on behalf of Steven W. Hamm, Consumer Advocate for the State of South Carolina (the Consumer Advocate), by AT&T Communications of the Southern States (AT&T), by MCI Telecommunications Corporation (MCI),[1] and by Andrew D. Woodham, Jr. Further, on March 22, 1991, the South Carolina Cable Television Association moved the Commission to be allowed to intervene out of time. GTE filed its memorandum in

1. MCI petitioned to intervene out of time on March 1, 1991. This petition was granted by Commission Order No. 91-208, issued on March 13, 1991.

opposition to the intervention on March 25, 1991. On April 1, 1991, the Commission issued Order No. 91-273, denying the Motion.

With its Application, the Company filed prepared direct testimony and exhibits of the following nine (9) witnesses: Bruce M. Holmberg, Vice President - Regulatory and Governmental Affairs, Jerry R. Austin, Treasurer, Norman L. Farmer, Director of Revenue and Earnings Management, Barry A. Johnson, Director of Regulatory Accounting, Edward W. Klassen, Staff Manager - Rate Design, Theodore W. Kunkle, Manager - Access Pricing, James W. Turner, Division Manager - State of South Carolina, Douglas E. Wellemeyer, Manager - Separations and Access Cost, and Dr. James Vander Weide, Research Professor of Finance and Economics - Duke University. The Company filed rebuttal testimony and exhibits on April 2, 1991 for the following witnesses: Larry B. Reed, Director of Accounting Operations GTE South, Inc., Douglas E. Wellemeyer, and Barry A. Johnson.

On February 7, 1991, the Commission directed the Staff and all other parties of record to file with the Commission and serve on all parties of record the testimony and exhibits of their intended witnesses by March 18, 1991. Subsequently, a two-day extension was granted to March 20, 1991. The Consumer Advocate timely filed the direct testimony and exhibits of Michael J. Ileo, President and Senior Economist of Technical Associates, Inc., John B. Legler, Professor of Banking and Finance, College of Business Administration at the University of Georgia, and David J. Effron, Certified Public Accountant. AT&T timely filed the direct testimony of Ronnie S. Dowdy, Manager - State Government Affairs for AT&T. Andrew D. Woodham, Jr. timely filed his direct testimony and exhibits. The Staff timely filed the direct testimony and exhibits of Thomas L. Ellison, Public Utilities Accountant, James M. McDaniel, Chief, Telecommunications Department, Gary E. Walsh, Assistant Director, Utilities Division, and Dr. R. Glenn Rhyne, Jr., Director of Research. Revised direct testimony and exhibits of Thomas L. Ellison and James M. McDaniel were subsequently filed and served.

Thereafter, in accordance with the applicable provisions of law in the Commission's Rules of Practice and Procedure, a public hearing relative to the matters asserted in the Company's Application was commenced on April 1, 1991. The Honorable Marjorie Amos-Frazier presided. M. John Bowen, Jr., Esquire, Thomas R. Parker, Esquire, Joe W. Foster, Esquire, and Wayne L. Goodrum, Esquire, represented the Company. Steven W. Hamm, Esquire, Elliott F. Elam, Jr., Esquire, and Carl F. McIntosh, Esquire, represented the Consumer Advocate, Francis P. Mood, Esquire, and Jay R. Gentry Ortiz, Esquire, represented AT&T, and D. Christian Goodall, Esquire, represented MCI. Andrew F. Woodham, Jr. was present at the hearing, but was not represented by counsel. F. David Butler, Esquire, represented the Commission Staff. The record consists of six (6) volumes of transcribed testimony and twenty-two (22) hearing exhibits. Briefs were filed on behalf of the Company, the Consumer Advocate, AT&T, and MCI. Members of the public were allowed input at the commencement of the hearing, and at a night hearing held in Myrtle Beach on April 11, 1991.

Upon full consideration of the Company's verified Application, the evidence presented at the hearing, and the applicable law, the Commission makes the following findings of fact and conclusions of law.

II.

FINDINGS OF FACT

1. The Company is a Virginia Corporation authorized to conduct a public utility business in the State of South Carolina. The Company is a wholly owned subsidiary of GTE Corporation.

2. The Company's present rates and charges were approved by Order No. 85-200, dated March 27, 1985 in Docket No. 84-390-C.

3. The Company owns and operates exchanges and lines providing local exchange telephone service to access lines located in Abbeville, Andrews, Bishopville, Calhoun Falls, Conway, Ehrhardt, Fairfax-Brunson, Georgetown, Hemingway, Hollywood, Johnsonville, Kingstree, Lake City, Lamar, Laurens, Manning, McCormick, Myrtle Beach, North Myrtle Beach, Olanta, Olar, Pamplico, Pawleys Island, Shawview Heights, Summerton, Sumter, Walterboro, Winnsboro, Woodruff, and Yemassee.

4. The appropriate test period for the purposes of this proceeding is the twelve-month period ending July 31, 1990.

5. By its Application, the Company is seeking an increase in its rates and charges for intrastate telephone service of $10,695,955.

6. The appropriate operating revenues for the Company for the test year under the present rates and after accounting and pro forma adjustments are $78,005,926 which reflects a $1,215,982 decrease in per book revenues.

7. The appropriate operating revenues under the approved rates are $82,384,135, which reflects a net authorized increase in operating revenues of $4,358,895, plus toll revenues of $19,314.

8. The appropriate operating expenses for the Company's intrastate telephone operations for the test year under its present rates and after accounting and pro forma adjustments are $64,802,375, which reflects a decrease in per book expenses of $4,503,106.

9. The appropriate operating expenses under the approved rates are $66,483,379.

10. The Company's appropriate level of net operating income for return after accounting and pro forma adjustments is $13,510,669.

11. The appropriate net income for return under the rates approved and after all accounting and pro forma adjustments is $16,207,874.

12. A year-end, original cost, South Carolina intrastate rate base of $149,602,354 consisting of the components set forth in Table B of this Order, should be adopted.

13. The capital structure utilized by the Commission in this proceeding for its determination of the Company's proper level of return on common equity is the GTE domestic telephone operations

capital structure as of September 30, 1990.

14. That Staff's embedded cost rates for long-term debt of 8.33% and the Staff's embedded cost rates for preferred stock of 6.39% subject to mandatory redemption and 6.22% not subject to mandatory redemption as of September 30, 1990, should be used in the determination of a fair, overall rate of return.

15. The reasonable rate of return on common equity that the Company should be allowed to earn is 12.50% which is adopted by the Commission for this proceeding. Combined with the debt and preferred cost rates and the capital structure set forth in the Table below, the Commission finds the reasonable, overall rate of return is 10.83%.

ITEM	PERCENT	COST	WEIGHTED COST
		%	%
LONG TERM DEBT	37.65%	8.33	3.14
PREFERRED STOCK (Subject to Mandatory redemption)	.36%	6.39	.02
PREFERRED STOCK (Not subject to Mandatory Redemption)	1.18%	6.22	.07
COMMON EQUITY	60.81%	12.50	7.60
TOTAL	100.00%		10.83%

16. That the Commission's decision on the Company's proposed incentive regulation plan shall be held in abeyance until further Order of the Commission.

17. That the rate designs and rate schedules approved by the Commission and the modifications thereto as described herein are

appropriate and should be adopted.

III.

EVIDENCE AND CONCLUSIONS

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NOS. 1, 2, AND 3.

The evidence supporting these findings concerning the Company's business and legal status, last major case concerning rates and charges, and location of company access lines, is contained in the Company's verified Application, in prior Commission Orders in the docket files, of which the Commission takes notice, in the testimony of Company witness Holmberg, and in the Exhibit of Staff witness McDaniel (Exhibit 17). These findings of fact are essentially informational, procedural, and jurisdictional in nature, and the matters which they involve are essentially uncontested.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 4 AND 5.

The evidence for these findings concerning the test period and the amount of the revenue increase requested by the Company is contained in the verified Application of the Company and the testimony and exhibits of Company witness Johnson.

On November 30, 1990, the Company filed an Application requesting approval of rate schedules designed to produce an increase in gross revenues of $10,695,955. The Company's filing was based on a test period consisting of the 12 months ending July 31, 1990. The Commission Staff and the parties of record herein likewise offered their evidence generally within the context of that same test period.

A fundamental principle of the ratemaking process is the establishing of a test year period. The reliance upon the test year concept, however, is not designed to preclude the recognition and use of other historical data which may precede or postdate the selected twelve month period.

Integral to the use of a test year, representing normal operating conditions to be anticipated in the future, is the necessity to make normalizing adjustments to the historic test year figures. Only those adjustments which have reasonable and definite characteristics, and which tend to influence reflected operating experiences are made to give proper consideration to revenues, expenses and investments. Parker v. South Carolina Public Service Commission, et.al., 280 S.C. 310, 313 S.E.2d 290 (1984). Adjustments may be allowed for items occurring in the historic test year, but which will not recur in the future; or to give effect to items of an extraordinary nature by either normalizing or annualizing such items to reflect more accurately their annual impact; or to give effect to any other item which should have been included or excluded during the historic test year. The Commission finds the twelve months ending July 31, 1990, to be the reasonable period for which to make our ratemaking determinations herein.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NOS. 6 THROUGH 11

The evidence for the findings concerning the adjusted level of operating revenues and expenses is found in the testimony and exhibits of Company witnesses Johnson and Reed, Consumer Advocate witness Effron, and Staff witnesses Ellison and McDaniel, (See

Hearing Exhibits 8, 13, 16, 17, and 22.)

The Company, the Consumer Advocate, and the Staff differed on many adjustments to operating revenue and operating expenses based on the Company's Application, testimony and exhibits, the Consumer Advocate's testimony and exhibits, and the Commission Staff testimony, and Staff Report. Where the parties concurred said adjustment need not be addressed, however, differences among the parties with regard to the various adjustments will be discussed.

ACCOUNTING AND *PRO FORMA* ADJUSTMENTS

ADJUSTMENT TO OPERATING REVENUES TO TRUE-UP REVENUE FROM POLE ATTACHMENT FEES

The Company proposes to true-up revenue received from pole attachment fees relative to prior periods. The Staff proposes to annualize such pole rental attachment fees. The Company proposes an adjustment of $(17,244) while the Staff proposes an adjustment of $28,798. The Commission is of the opinion that the annualization of poll rental attachment fees is the appropriate treatment, therefore, the Commission adopts Staff's adjustment.

ADJUSTMENTS TO REFLECT TEST YEAR UNCOLLECTIBLES AT A NORMAL RATE

Both the Staff and the Company propose to adjust the books to reflect the impact of accounting and *pro forma* adjustments on Uncollectible Expenses. Staff adjusted the uncollectible rate to reflect a normal year. Uncollectibles booked during the test year were affected by Hurricane Hugo. With regard to adjustments to operating revenues, the Staff adjustment is in the amount of ($135,654), while the Company adjustment is in the amount of

($35,203). With regard to Corporate Operations Expense Adjustments to reflect the test year uncollectibles, the Staff recommends an adjustment of ($410,250), whereas the Company recommends an adjustment of ($106,461). The Commission believes that it is appropriate to adjust uncollectibles using an uncollectible rate which reflects a normal year. Applying a normalized rate to the appropriate adjusted book level of revenues results in stating uncollectible expenses as would be typical in a normal year. Therefore, the Staff adjustments are adopted.

ADJUSTMENT TO CORPORATE OPERATION EXPENSE TO REFLECT THE ELIMINATION OF CUSTOMER PREMISE EQUIPMENT (CPE)

Both the Staff and the Company propose to remove revenues and expenses associated with the deregulation of customer premise equipment (CPE). The Company requested an adjustment to Corporate Operations Expense of ($47,421) whereas the Staff recommends an adjustment of ($52,788). Staff used a 12 month average of the general allocator whereas the Company used a 3 month average of such allocator to assign Corporate Operations Expense to deregulated CPE. The Commission finds the use of a 12 month average to be appropriate. The Commission adopts the Staff adjustment.

ADJUSTMENT TO REFLECT THE ELIMINATION OF ITEMS CONSIDERED NON-ALLOWABLE FOR RATEMAKING PURPOSES

The Staff proposes to eliminate items considered non-allowable for ratemaking purposes from expenses. Such adjustment includes employee newsletters and bulletins, contributions, institutional advertising, membership dues to certain organizations and clubs, employee gifts and awards, and miscellaneous other items such as flowers, and novelty items. Staff also included sample items for which the Company did not provide support. It has always been Commission policy in past rate cases to eliminate such items as listed above from expenses for ratemaking purposes. Therefore, the Commission adopts the Staff's adjustment of ($44,295) for the toll revenue effect. Similarly, the Commission adopts Staff's adjustment of ($379,494) from operating expenses to reflect the elimination of these items for ratemaking purposes.

ADJUSTMENT TO OPERATING TAXES TO REFLECT THE EFFECTS OF INTEREST SYNCHRONIZATION

Both the Staff and the Consumer Advocate's office propose adjustments to operating taxes to reflect the effects of interest synchronization. The Company failed to propose such an adjustment. The Staff recommends an adjustment of $134,325, whereas the Consumer Advocate recommends an adjustment of $408,062. After due consideration, and consideration of the calculation of both the Staff and Consumer Advocate's figures, the Commission is of the opinion that the Staff calculation is the correct one and therefore, adopts Staff's figures. Staff's interest synchronization adjustment is calculated based on the Staff's rate base adjustments, cost of debt components, and capital structure, and therefore no adjustment of interest synchronization other than the Staff's is appropriate.

HURRICANE HUGO ADJUSTMENT

The Staff proposes an adjustment to operating revenues of $36,956 to reflect the toll impact of its extraordinary retirements due to Hurricane Hugo. Staff adjusted corporate operations expense by $493 for the uncollectible expenses related to such toll revenue. The Commission is of the opinion that such adjustments are appropriate under ratemaking principles and, therefore, adopts Staff's adjustments.

The Staff proposes to amortize retirements due to Hurricane Hugo over a three-year period. The Commission is of the opinion that the Staff's adjustment of $321,344 is consistent with good ratemaking policy and correctly reflects amortization of retirements due to the Hurricane Hugo over a three-year period. The Commission finds that the retirement of plant damaged by Hurricane Hugo is an extraordinary retirement and should be removed from rate base, since the equipment is no longer used and useful in providing telecommunications service. The Commission finds that Staff's treatment is in accordance with the Federal Communications Commission (FCC) Chart of Accounts. The Commission finds that a three year amortization is appropriate in this case. Therefore, the Commission adopts Staff's adjustment.

SALARIES AND WAGES

Both the Company and the Staff propose adjustments to reflect a *pro forma* level of salaries and wages. With regard to operating revenue, the Staff proposes an adjustment of $4,716 and the Company proposes an adjustment of $36,445. The Staff's adjustment is based on verifiable wage increases, including annualization. Therefore, the Commission adopts Staff's adjustment to operating revenue for the toll effect. With regard to operating expenses, Staff has proposed an adjustment of $40,146, whereas the Company has proposed an adjustment of $311,139. Again, the Staff's adjustment is based on verifiable information, and, therefore, the Commission adopts Staff's adjustment. Both the Staff and the Company propose adjustments to payroll taxes and insurance due to changes in salaries and wages and insurance rates. Staff proposes an adjustment to toll revenue of $5,858, whereas the Company proposes an adjustment of $16,565 to operating revenue for the toll effect. With regard to operating expenses, Staff proposes an adjustment of $49,136, whereas the Company proposes an adjustment of $139,335. Again, the Staff adjustments reflect consideration of verifiable information and the Commission, therefore, adopts Staff adjustments to both operating expense and operating revenue.

GTE DIRECTORIES, INCORPORATED

The Staff proposes to book the effect of operating GTE Directories, Incorporated as a separate company. Staff's adjustment includes an annual effect of increases in directory sales. The Company proposes to adjust revenue for directory revenue rate increases in both sales price and advertisement rates. Staff's adjustment did not include increased revenues due to increases in directory advertisement rates. Both the Staff and the Consumer Advocate propose to increase revenues to recognize pretax income earned by GTE Directories on its South Carolina operations.

The Consumer Advocate believes that directory operations that are related to the provision of utility services add substantial value to telephone services and are necessary to the provision of reasonably adequate telephone services. Therefore, the Consumer Advocate contends that the income generated from directory operations should be recognized as a credit in the determination of the Company's jurisdictional revenue requirements, rather than being diverted or placed under an unregulated affiliate. The Staff proposes to book the effect of operating GTE Directories as a separate company in the amount of $673,982. The Company proposes an adjustment of $204,920, whereas the Consumer Advocate proposes an adjustment of $839,920. After due consideration, this Commission believes that the Staff's proposal to book the effect of operating GTE Directories, Incorporated as a separate company is a correct approach and that the Staff adjustment should be adopted. Although the Company argues that the Staff's adjustment, in effect, eliminates GTE Directories, Incorporated, as a separate company from GTE South, it is the position of the Commission that the operations of GTE Directories Incorporated are so closely linked with that of the telephone operations that the effect of operating the Company as a separate company should be booked as operating revenue to the telephone operations. The Staff adjustment is adopted, since this Commission believes that the Staff figure more accurately eliminates the effect of booking of GTE Directories, Inc., as a separate Company.

In Order No. 85-1, Docket No. 84-308-C (1985), this Commission addressed the effect of Southern Bell's decision to cease publishing its own directories and to form a subsidiary to conduct its directory operations. The Commission stated that "to ensure that the establishment of BAPCO [the subsidiary] as a separate company caused no revenue requirement increase for Southern Bell's intrastate operations in South Carolina, it is necessary to make a pro forma adjustment, to test year directory revenues." Order No. 85-1, page 26. Based upon its determination that the establishment of the subsidiary's operations should not adversely affect the Southern Bell ratepayers, the Commission required all of the subsidiary's revenues to be included as part of Southern Bell's operating revenues for ratemaking purposes. The Commission believes that this decision must be followed in this case.

This case (GTE) must be differentiated from that addressed in our Order No. 91-362 issued May 28, 1991, in Docket No. 89-229-C, United Telephone Company of the Carolinas (United). In that case, United's directory operations were originally performed by L. M. Berry Company, a completely independent publishing company. Under the Company's agreement with Berry, the Company received 60% of the revenues from directory operations (and paid certain related expenses) and 40% of the revenues remained with Berry. United contended and the Commission agreed that, unlike the circumstances in Docket No. 84-308-C, where Southern Bell published and received all revenue from its directories and then created a subsidiary to conduct its directory operations, the creation of the subsidiary DirectoriesAmerica under United did not have a revenue impact on its ratepayers because it continued to impute 60% of DirectoriesAmerica's revenues to its books as it did under its agreement with Berry. No adverse effect to the Company ratepayers was likely to occur. (The Commission did, however, put United on notice that in future rate proceedings, it would impute 100% of the directory operations.)

The case at bar is different. Despite the Company's protestations to the contrary, Tr. 5, Johnson, at 88-89, GTE Directories, Inc., unlike Berry in the United case, has always been an affiliate of GTE South, Inc., and its directory operations are related to the provision of utility services, add substantial value to telephone services, and are necessary to the provision of reasonably adequate telephone services. Tr. 4, Effron, at 59. This linkage demands recognition as operating revenue to the telephone company. The situation in the case at bar is similar to what the Commission addressed in its Southern Bell Order No. 85-1, in that, without the adjustment, an adverse effect to the Company's ratepayers could occur. Therefore, this case is distinguishable from United, but similar to the Southern Bell case. Southern Bell Order No. 85-1 must govern our approach in the case at bar, even though it did not in the United case.

ADJUSTMENT TO OPERATING REVENUES TO DECREASE REVENUES DUE TO A DECREASE IN AT&T'S BILLING AND COLLECTION RATES

Both the Company and the Staff propose an adjustment to operating revenues to decrease revenues due to a decrease in AT&T's billing and collection rates. The Company proposes an adjustment of ($98,243), whereas the Staff proposes an adjustment of ($70,808). Staff's adjustment is based on annualizing the actual decrease in billing and collection rates which took place during the test period. The Company estimated the amount of such decrease. The Staff's adjustment is hereby adopted.

RATE CASE EXPENSES

Both the Staff and the Company propose to record the effects of amortizing expenses associated with this current rate case. The Company's adjustment is based upon estimated expenses, whereas the Staff used actual verifiable expenses to date. Both parties proposed a three-year amortization of the expenses. Since the Staff used actual verifiable expenses to date, the Commission hereby adopts Staff's position. Staff's adjustment of $206 for the toll revenue effect versus the Company's adjustment of $1,396 for toll is hereby adopted.

The Company proposes an adjustment to corporate operation expense of $12,149, whereas the Staff proposes an adjustment of $1,789. The Commission hereby approves Staff's adjustment, for the reasons stated above.

COMPANY REORGANIZATION

Both the Staff and the Company propose to recognize the net cost savings related to the Company's reorganization ("Winning Connection II."). Staff proposes an adjustment of ($107,283), to toll revenue whereas the Company proposes an adjustment of ($83,517). Both Staff and the Company propose an adjustment to operating expenses to recognize the net cost savings related to the

Company's reorganization. The Staff proposes an adjustment of ($926,476), whereas the Company proposes an adjustment of ($721,397). The Staff used actual costs in its calculations relating to pro forma savings which will result from the reorganization. The Company's adjustment made use of cost estimates to project savings. The Staff's adjustment seems the most appropriate of the two and is therefore adopted.

OTHER POST RETIREMENT BENEFITS

The Company and Staff have included in their respective revenue requirements the effects of implementing Other Post Retirement Benefits (OPRB). On the other hand, the Consumer Advocate suggested that this adjustment should not be accepted by the Commission. Staff and the Company's adjustments come under the recently issued Financial Accounting Standards Board Statement (FASB) 106. The adoption of FASB 106 was done to improve employers' financial reporting for post-retirement benefits. By adopting this statement, the accounting methodology for these benefits will change from a cash basis to an accrual basis. Thus, instead of accounting for costs on a pay as you go basis, cost recognition will take place over the career life of the employee and correspond to when the benefit was actually earned. This will result in a much better match between costs and the events giving rise to these costs. By including the effects of OPRB on the revenue requirement, an adjustment in this area will avoid the significant rate impact which will take place the year that OPRB is mandated (i.e. 1993). The accrual and actual techniques utilized under OPRB are similar to those utilized in the normal pension calculations. Therefore, the Company and Staff have advanced an adjustment which, in the Commission's opinion, will work to the benefit of the Company's ratepayers. Staff proposes an expense adjustment of $512,483 which has a toll revenue impact of $59,434, whereas the Company proposes an adjustment of $574,187, with a toll impact of $67,918. The Staff position is a more appropriate one since it is based on actual dollars as much as possible in arriving at the adjustment amount. The Staff adjustment is therefore adopted.

REVISIONS IN NON-REGULATED ALLOCATION PROCEDURES

Both the Staff and the Company proposed to reflect the impact of revisions in non-regulated allocation procedures. The Staff did not annualize such impact due to fluctuations of allocated amounts outside the test year. Staff's adjustment is most appropriate and Staff's said adjustment is therefore adopted by this Commission. Staff recommends an adjustment of ($1,279), to expenses and $303 to toll revenue whereas the Company recommends an adjustment of $128,366 to expenses and $16,074 to toll. Staff's adjustments are hereby adopted.

DEPRECIATION

The Staff and the Company proposed to adjust depreciation expense to an end-of-period level using represcribed depreciation rates as of July 1, 1990. Staff's adjustment differs due to computational methodology and the calculation of amortization of leasehold improvements. Staff proposes an adjustment of $993,986, whereas the Company proposes an adjustment of $1,063,429. The

Consumer Advocate's proposal of $371,429 differs from the Company proposal due to the treatment of the customer premises wiring account. The Consumer Advocate proposes to amortize the amount remaining on the Company's books as of July 1991, when the rates in this case go into effect, over three years. The Consumer Advocate states that if this is not done, then the Company will recover more for this expense through rates than it recognizes on its books. After due consideration, the Commission believes that the Staff's position most accurately reflects the depreciation expense using the represcribed rates and end of period depreciable plant balances and therefore, adopts Staff's position.

PROPERTY TAXES

The Staff and the Company propose to adjust for the pro forma level of property taxes. The Staff used updated property tax assessments and rates. The Staff proposed an adjustment to operating revenues of $36,827, whereas the Company proposed an adjustment of $42,464 for the toll effect. Likewise, both Staff and the Company proposed an adjustment to operating taxes to reflect the proposed adjustment to property tax expense. These adjustments are net of income taxes. Staff proposes an adjustment to expenses of $205,250, whereas the Company proposes an adjustment of $236,672. Since the Staff used updated property tax assessments and rates as a basis for its calculations, the Commission is of the opinion that the Staff's adjustments should be approved.

SOUTH CAROLINA USE OF FACILITIES LOCATED IN OTHER STATES

Both Staff and the Company proposed to true-up capital carrying charges for South Carolina's use of facilities located in other states. Staff included South Carolina's share of such facilities in rate base in lieu of allowing a return on the investment component to be included in carrying charge rates. Staff eliminated charges for property not yet used by South Carolina and did not go outside of the test year on investment levels. With regard to operating expenses, Staff proposed an adjustment of ($826,030) versus the Company's proposed adjustment of $44,918. The Staff's proposed adjustment is adopted. The Commission also adopts Staff's proposed adjustment to toll of ($100,323) instead of the Company's proposed adjustment of $5,234.

INTEREST DURING CONSTRUCTION

Both Staff and the Company propose to reflect Interest During Construction (IDC) at an end-of-period level. Staff's adjustment includes IDC on a project which was reclassified from short-term to long-term after the test year ended. Staff, therefore, adjusted an item during the test year for known and measurable changes. For this reason, the Staff adjustment of $48,782 is approved instead of the Company's proposed adjustment of $18,316.

OUT OF PERIOD ITEMS

Both Staff and the Company proposed to adjust the books for miscellaneous out-of-period items. Staff proposes an adjustment to operating revenues of ($12,799), whereas the Company proposes an adjustment of ($714). With regard to operating expenses, Staff recommends an adjustment of ($92,339), whereas the Company recommends an adjustment of $5,473. During Staff's audit, Staff found certain errors in the Company's normalization adjustments. The Commission is of the opinion that the Staff adjustments, as recommended to both operating revenues and operating expenses, most correctly reflect adjustments for the out-of-period items.

PROPERTY HELD FOR FUTURE USE

Staff makes a recommendation for adjustments to both operating revenues and operating taxes to reflect the removal of property taxes associated with Property Held for Future Use. Staff has proposed an adjustment of ($392) to operating revenues and ($1,670) to operating taxes (net of income taxes) to reflect the removal of property taxes associated with property held for future use. Such future use property represents a building which was replaced and was booked to property held for future use in error. The Commission approves Staff's adjustment to both operating revenues and operating taxes.

GROSS RECEIPTS TAXES AND LICENSE FEES

Both Company and Staff propose adjustments to operating revenues and operating taxes to reflect gross receipts taxes, and license fees on a pro forma level. The Staff recommends an adjustment of ($3,157) to operating toll revenue, whereas the Company recommends an adjustment of ($3,925). With regard to operating taxes, the Staff recommends an adjustment of ($17,594) whereas the Company recommends an adjustment of ($21,880) net of State and Federal taxes. The Commission believes that the Staff's adjustment to both operating revenues and operating taxes most accurately reflects a pro forma adjustment of gross receipts taxes and license fees, therefore, the Staff's adjustments are approved. This reflects gross receipts on revenues approved in this Order, based on Staff's report. Gross receipts taxes on other revenue adjustment approved herein are contained in such adjustment.

LEGAL FEES

The Staff proposes to eliminate legal fees connected with a lawsuit involving deregulated operations and legal fees which should have been assigned to North Carolina. Staff proposes an adjustment of ($4,114) for the toll effect. The Commission finds such an adjustment to be appropriate, since deregulated operations should not be charged to the Company, nor should North Carolina legal fees. Similarly, Staff recommends an adjustment of ($28,346) to corporate operations expense to reflect the elimination of the same legal fees. Again, for the same reasons, the Staff's adjustment is adopted.

BUSINESS LICENSE TAXES AND FRANCHISE FEES

Staff also proposes adjustments to operating revenues and operating taxes to reflect the removal of municipal business license taxes and franchise fees from expenses. Staff proposes an adjustment of ($72,208) to operating revenues for the toll effect and ($307,450) to operating taxes (net of State and Federal Income taxes). The Commission takes the position that municipal business license taxes and franchise fees should be passed on to the ratepayer as a separate line item on the customers' bills and should be billed only to the ratepayer living in the jurisdiction imposing the tax. The Staff adjustments recognize this principle, and are therefore adopted.

MORTGAGE INTEREST RATE DIFFERENTIALS

The Staff proposes to lower the expenses for amounts paid by the Company relating to mortgage interest rate differentials. Such interest is not considered to be an above-the-line item. Therefore, the Staff's proposed adjustment of ($244) to operating revenues for the toll effect is hereby approved and the Staff's proposed adjustment of ($1,699) to operating expenses is hereby approved.

MEMBERSHIP DUES AND LOBBYING

The Staff proposes to remove the portion of membership dues payments to telephone associations which are related to lobbying, entertainment and other items not considered to be allowable for ratemaking. Therefore, the Staff's proposed adjustment of ($374) for the toll effect is approved, as is the Staff's proposed adjustment of ($2,573) to corporate operations expense. Further, the Staff proposes to remove the cost associated with lobbying from above the line expenses. Such adjustment includes lobbying in South Carolina and allocated lobbying from the Washington, DC office, south area operations, and general office operations. Therefore, the Commission approves Staff's adjustments of ($7,660) to operating revenues for the toll effect and ($52,776) to corporate operations expenses.

TOLL POOL IMPACT

The Staff proposes to adjust revenues for the toll pool impact of Staff's rate base adjustments in the amount of $126,375. The

Commission finds this adjustment to be appropriate and therefore adopts it.

OFFICER PAY INCREASES

The Staff proposes to remove officer pay increases from test year expenses. This is consistent with this Commission's treatment of such increases in prior utility rate cases involving major utility companies. Therefore, the Staff's adjustment of ($1,367) for the toll effect is approved, as is the Staff's adjustment of ($11,895) to corporate operations expense.

BENEFITS

Staff also proposes an adjustment of ($247) to operating revenues for the toll effect and ($2,146) to corporate operations expense to reflect removal of related benefits associated with officer pay increases. Since this is also consistent with previous Commission treatment of such increases, the Staff's adjustments are adopted.

REDUCTION IN EMPLOYEE LEVELS

Both the Staff and the Consumer Advocate propose an adjustment to operating revenues and operating expenses to reflect a reduction in employee levels after the test year ended. The Staff proposes an adjustment of ($9,356) to operating revenues for the toll effect whereas the Consumer Advocate proposes an adjustment of ($38,000). With regard to operating expenses, the Staff recommends an adjustment of ($78,546) whereas the Consumer Advocate recommends an adjustment of ($323,000). The Commission is of the opinion that the Staff adjustments to operating revenues and operating expenses more correctly reflect the revenues and expense levels reflecting a reduction in the employee levels after the test year ended. The Staff's adjustment places salaries and wages on a going forward level. Therefore, the Staff adjustments are adopted. The Staff also recommends adjustments to operating revenues and operating expenses to reflect elimination of related benefits and taxes due to the reduction in salaries and wages associated with changes in employee levels. Staff recommends an adjustment of ($2,415) to operating revenues and ($20,177) to operating expenses. The Commission believes that such adjustments are appropriate and such adjustments are therefore adopted.

TOLL POOL NORMALIZATION

The Staff, the Company, and the Consumer Advocate all proposed adjustments to operating revenue to adjust toll pool revenues to reflect a normalized amount. Both the Staff and the Company recommend an adjustment of ($3,016,004). The Consumer Advocate recommends lowering the above adjustment by $2,103,000 resulting in an adjustment of ($913,004). The Commission is of the opinion that the Consumer Advocate's adjustment most accurately reflects a proper adjustment to the operating revenue to adjust toll pool revenues to reflect a normalized amount. The Consumer Advocate's testimony points out that the Company's toll pool normalization adjustment is tainted by Hurricane Hugo. The months in which toll revenues were abnormally low were the months immediately following Hurricane Hugo. Tr. 4, Effron at 54-55. The Consumer Advocate recommends that the revenues for the twelve month period ending

January, 1991 be used as the normalized level of toll revenues. The testimony of David Effron noted that this is reasonable because it eliminates the months in the test year which appear to have been abnormally low, and the midpoint of the twelve months ended January 31, 1991 is July 31, 1990, which is the date as of which the rate base is calculated. Therefore, the use of this twelve month period is consistent with a July 31, 1990 rate base date. The effect of utilizing this period is to increase the normalized level of toll revenues included in total test year operating revenues by $2,103,000. Tr. 4, Effron at 55. The Commission agrees with the Consumer Advocate's assessment and reasoning, and therefore, the Commission adopts the Consumer Advocate's adjustment, based on this reasoning.

1990 BASIC STUDIES CHANGES

Both Company and Staff propose an adjustment to operating revenues to reflect the impact of the 1990 Basic Study Changes on message toll and private line revenues. The adjustment reduces operating revenues by $1,014,067. The Consumer Advocate opposes this adjustment. Since the intraLATA Toll and Private Line division of revenue process is based on the FCC Part 36 separation procedures, the Basic Study Changes would have an impact on the intrastate intraLATA division of revenue process. The result of the studies is a shift of Company cost to local service. Therefore, the Basic Studies would cause a reduction in toll revenues. The Commission recognizes the impact of the Basic Study Changes and accordingly holds that the adjustment to toll revenue is fair and reasonable.

CHANGES IN SEPARATION PROCEDURES

The Company and Staff have proposed to reduce operating revenue to reflect changes in transitional separation procedures. The separations procedures set forth the method of allocating costs of operations between the intrastate and interstate regulatory jurisdiction. These approved procedures are contained in the Federal Communications Commission's Rules and Regulations - Part 36. In these procedures the Commission has adopted a transitional SPF (Subscriber Plant Factor) to move to an interstate gross allocator of 25% and transitional DEM factor to move to a unweighted Dial Equipment Minutes (DEM). In this case, the transitional changes will result in a portion of the Company costs to be shifted to the intrastate jurisdiction. Since the Part 36 procedures are also used for the division revenue process for intraLATA cost and revenues. The procedures will cause a shift of intrastate intraLATA service cost to local service cost. The Company and Staff adjustment will result in a net reduction of operating revenues in the amount of $485,763. The Consumer Advocate witness Effron recommended that Commission not recognize these adjustments to toll revenues. The Consumer Advocate witness recommendations increase revenues by $1,641 related to these transitional separation procedures. The Commission recognizes that these procedures were adopted by the Federal Communications Commission and recognizes that the results of the Part 36 procedures will be a shift in cost to the intrastate jurisdiction for GTE South. Therefore, the Commission finds that these revenue reductions which are based on studies using Part 36 procedures are appropriate.

GTEDS

The Consumer Advocate proposes an adjustment of ($34,000) to operating revenues and ($288,000) to plant non-specific expense to remove excessive amounts paid to GTE Data Services Incorporated (GTEDS). Neither, the Staff nor the Company has proposed such adjustments. Larry B. Reed, rebuttal witness for the Company, correctly points out that the Consumer Advocate witness David Effron supports the proposed adjustments simply because GTEDS earns a particular rate on equity on its transactions with its affiliate, GTE South. Tr. 5, Reed at 11. See, Tr. 4, Effron, at 66, where Effron states that GTEDS earned a return on average equity of approximately 22% in 1989. Reed is correct in his assertion. The Commission finds that the rate of return by GTEDS for the test year was comparable to the industry, since the average rate of return on common equity for members of the data processing industry was 24.9%, in any case. See, Tr. 5, Reed at 24; Hearing Exhibit 19, Schedule 5. The Consumer Advocate's adjustments are therefore rejected.

The Consumer Advocate objects to portions of Company rebuttal witness Reed's testimony and exhibits (Hearing Exhibit 19) regarding studies prepared by companies other than GTE as being hearsay and being an improper attempt to get documents into the record in such a way that would run afoul of the Uniform Business

Records as Evidence Act, S.C. Code Ann.§19-5-510. As we understand it, the Consumer Advocate's objections pertain specifically to Reed's Rebuttal Schedules 1, 2, 3, and 6 of Hearing Exhibit 19. The Consumer Advocate also cites State v. McFarlane, 306 S.E.2d 611 (S.C. 1983). In support of his objection, the Consumer Advocate questions schedules containing studies prepared by Price Water House, Pricing Advisor, and Real Decisions, Transcript 5 at 5 through 7, 17, and 25. The objection of the Consumer Advocate must be sustained.

First, the studies in controversy do not fall within the auspices of the Uniform Business Records as Evidence Act. They were not proffered as documents prepared during the regular course of business. See, Transcript 5 at 25. Therefore, the act is inapplicable, as is State v. McFarlane, supra. However, the Consumer Advocate is correct in asserting that the studies in controversy are hearsay, therefore, schedules 1, 2, 3, and 6 are hereby excluded from Hearing Exhibit 19, as is the testimony of Reed relating to those schedules.

Schedules 4 and 5 however, are a different matter. Schedules 4 and 5 both appeared to be studies performed by GTE Data Services. The scope of the Consumer Advocate's objection did not relate to anything other than "outside studies and the schedules themselves". Tr. 5 at 5. The Consumer Advocate's objection did not relate to studies performed by GTE Data Services. Therefore, schedules 4 and 5 of Hearing Exhibit 19 shall remain in evidence and, therefore, the record of this case, as shall the Reed testimony explaining such schedules.

Further, the Commission hereby notes that it did not rely on any of the excluded studies or testimony in making its decision to exclude the Consumer Advocate's proposed adjustment on GTEDS, but it relied only upon the evidence remaining in the record after the hearsay exclusions.

INCOME TAXES

Both the Company and the Consumer Advocate propose an adjustment to true-up income taxes to an adjusted level. The Staff's proposed adjustment is $211,619. Both the Company and the Consumer Advocate propose an adjustment of ($201,498). Staff's adjustment is accepted as being the most consistent with the adjusted taxable income level resulting from adjustments approved in this case. Both the Company's and the Consumer Advocate's proposals are rejected.

Based upon its acceptance of accounting and _pro forma_ adjustments to the Company's operating revenues and expenses, the Commission concludes that the appropriate operating revenues and expenses for the Company's intrastate telephone operations for the test year under its present rates are $78,005,926 and $64,802,375 respectively.

CUSTOMER GROWTH

Consumer Advocate proposed an adjustment for customer growth. Staff proposes to record customer growth in the amount of $224,940. The Company proposes an adjustment of $202,506, while the Consumer Advocate proposes an adjustment of $63,000. As a result of the adoption of the Consumer Advocate's adjustment for toll pool revenue normalization, the Commission finds that the appropriate level of customer growth is $249,547, based on Staff's methodology.

Based upon its finding of an appropriate net operating income and operating expenses, the Commission concludes that the appropriate level of net operating income for return after accounting and pro forma adjustments is $13,510,669. This calculation is shown in Table A.

TABLE A
NET INCOME FOR RETURN

	$
BEFORE RATE INCREASE	
Operating Revenues	78,005,926
Operating Expenses	64,802,375
Net Operating Income	13,203,551
Interest During Construction	57,571
Customer Growth	249,547
Net Income for Return	13,510,669
AFTER RATE INCREASE	
Operating Revenues	82,384,135
Operating Expenses	66,483,379
Net Operating Income	15,900,756
Interest During Construction	57,571
Customer Growth	249,547
Net Income for Return	16,207,874

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NO. 12

The evidence supporting these findings concerning proper methodology and level of cash working capital and proper items to be included in the Company's rate base can be found in the exhibits and testimony of Company witness Johnson, Consumer Advocate witness Effron, and Commission Staff witness Ellison.

Pursuant to S.C. Code Ann.,§58-9-570 (1976), in ratemaking proceedings involving a telephone utility the Commission must "give due consideration to the telephone utility's property devoted to the public service...." Such consideration is traditionally made in the context of the determination of the utility's rate base.

For ratemaking purposes, the rate base is the total net value of the telephone utility's tangible and intangible capital or property value on which the telephone utility is entitled to earn a fair and reasonable rate of return. The rate base, as allocated to the Company's operations, is composed of the value of the Company's property used and useful in providing telephone service to the public, plus telephone plant under construction materials and supplies, and an allowance for cash working capital and property held for future use; less accumulated depreciation, accumulated deferred income tax (liberalized depreciation) and customer deposits. The Accounting Department of the Administration Division of the Commission Staff, prior to the date of the hearing, conducted an audit and examination of the Company's books and records, including rate base items, with plant additions and retirements. On the basis of this audit, the exhibits and the testimony contained in the entire record of the hearing, the Commission can determine and find proper balances for the components of the Company's rate base and other items.

When the rate base has been established, the Company's total operating income for return is applied to the rate base to determine what adjustments, if any, to the present rate structure are necessary to generate earnings sufficient to produce a fair rate of return or those adequate to meet the needs of the Company. The rate base should reflect the actual investment made by investors in the Company's property and the net value upon which stockholders will receive a return on their investment. This Commission is among the majority of States which provide for the determination of rates based on a "year end" basis, which appears most reasonable to reflect the prospective operation of any ratemaking action, and has traditionally done so. The use of a "year end" rate base likewise serves to enhance the timeliness of the effect of such rate actions and preserves reliance on historic and verifiable figures without resort to anticipated or projected figures. Consequently, the Commission finds it most reasonable to retain its consistent regulatory practice herein and evaluate the issues herein founded on a rate base as of July 31, 1990.

The Commission's determinations relative to the Company's rate base for its intrastate operations appear in the paragraphs below.

SOUTH CAROLINA SHARE OF PLANT LOCATED IN OTHER STATES

Staff proposes to make an adjustment to both plant in service and to accumulated depreciation to book South Carolina's share of plant located in other states. Staff proposes an adjustment of $6,830,891 to plant in service and ($1,852,131) to accumulated depreciation. The Commission finds such adjustments to be appropriate in order to adjust present South Carolina figures to take into account the share of plant located in other states. Therefore, the Commission approves Staff's adjustments as stated above.

In addition, Staff proposes an adjustment of $119,788 to plant under construction, ($45,611) to cash working capital and ($865,943) to accumulated deferred income taxes. Again, all of these are to book South Carolina's share of plant located in other states. The Commission finds these adjustments to be appropriate as well for the reasons listed above.

ACCUMULATED DEPRECIATION

Both the Staff and the Consumer Advocate propose an adjustment to accumulated depreciation to reflect the annualized depreciation expense on an end-of-period basis. The Staff recommends an adjustment in the amount of ($747,661). The Consumer Advocate recommends an adjustment of ($371,429). The Commission believes that the Staff's adjustment most accurately reflects the effect of annualized depreciation on an end-of-period rate base, and therefore adopts the Staff's adjustment. The Staff also recommends an adjustment to accumulated deferred income taxes to reflect the deferred tax effects of annualizing depreciation expense on an end-of-period basis. The Staff's adjustment of $242,244 is approved because of the reasoning stated above.

DEBIT RESERVE BALANCES

Staff proposes an adjustment of ($582,032) to reflect an adjustment to accumulated depreciation to remove debit reserve balances from rate base. The Commission believes that this adjustment is appropriate and should be adopted.

On May 24, 1989, the Commission issued Order No. 89-539 under Docket No. 88-661-C in which a three (3) year amortization of the net book balance of electric operator systems-digital and analog switching equipment was approved effective January 1, 1989. Such electric operator systems-digital and analog switching equipment was replaced with digital equipment which is included in the Company's rate base. The Company is writing off the debit balance in accumulated depreciation to depreciation expense over the three (3) year period approved by this Commission. The Staff's adjustment was made due to the fact that such electric operator systems-digital and analog switching equipment is no longer used and useful in rendering telecommunications service to the ratepayer. Without Staff's adjustment to lower rate base, the Company will be allowed to earn a return on both the retired equipment and the replacement equipment at the expense of the ratepayer. The Staff's method of removing the retired equipment from rate base provides for a sharing between the ratepayer and the shareholder since the Company is given an above the line write-off of the expense but is not allowed a return component. This is the method which this Commission has used when granting early retirements to other telephone utilities under its jurisdiction.

Therefore, the Company should transfer the debit balance in the reserve account to a deferred retirements account which will be written off over the three (3) year period specified by this Commission. The Commission finds this treatment to be in accordance with the Uniform System of Accounts.

MATERIALS AND SUPPLIES

Staff recommends an adjustment of ($939,757) as an adjustment to materials and supplies to reflect amounts contained on the materials and supplies sub-ledger. The Commission believes that such an adjustment is needed to accurately reflect the amount of materials and supplies presented by the Company. Therefore, said adjustment is adopted.

CASH WORKING CAPITAL

Staff proposes an adjustment to cash working capital to reduce rate base for unclaimed funds. The adjustment is in the amount of ($42,149). Unclaimed funds represent amounts owed by the Company to persons who the Company has not been able to locate to make payment. This gives the Company use of this money and reduces the cash working capital requirement. The Commission believes that the adjustment is needed to reduce rate base properly before the rate base is adopted.

The Staff proposed to reduce working capital for correcting adjustments only. The Company proposed to adjust for pro forma adjustments, and the Consumer Advocate used the lead lag method to arrive at the cash working capital requirement. Staff's proposed adjustment is ($246,996), the Company's proposed adjustment is

($127,687), and the Consumer Advocate's proposed adjustment is a negative cash working capital requirement of ($666,000). The Staff and the Company computed cash working capital by the formula method, whereas the Consumer Advocate witness adopted the lead lag study approach. This Commission has traditionally used a formula method and has found that it adequately reflects a company's cash working capital allowance. Therefore, the Staff's adjustment of ($246,996) is hereby adopted.

PENSION LIABILITY

Both the Staff and the Company propose to reduce rate base to reflect the removal of the portion of pension liability funded through the OPRB adjustment. The Staff's adjustment reduces rate base by a net effect of <$321,336>, whereas the Company's adjustment is <$116,157>. The Commission finds that it is appropriate to reduce the liability from rate base since the Company is seeking recovery on a pre-adoption basis. The Staff's adjustment is based on actual dollars whenever possible. The Commission finds that such an adjustment is consistent with sound accounting principles, and therefore, Staff's adjustment is approved by this Commission.

CUSTOMER DEPOSITS

Staff proposes an accounting adjustment of ($1,458) to customer deposits to recognize the rate base effect of annualizing interest on customer deposits. The Commission approves this principle and this adjustment.

PLANT UNDER CONSTRUCTION

Staff proposes an adjustment to plant under construction to capitalize a portion of the pro forma wage increase. Staff's recommended adjustment is in the amount of $19,533. Said adjustment is hereby approved as it is consistent with sound regulatory accounting principles.

PROPERTY HELD FOR FUTURE USE

Staff has recommended an adjustment of ($149,621) to property held for future use to adjust rate base for a building which was replaced and subsequently destroyed. The Commission finds this adjustment to be appropriate and said adjustment is therefore adopted.

NON-ALLOWABLE ITEMS FROM RATE BASE

Staff proposes an adjustment to plant in service of ($7,921) to exclude non-allowable items from rate base. Further, Staff proposes an adjustment of ($11,007) to accumulated depreciation to exclude non-allowable items from rate base. Finally, Staff proposes an adjustment of ($3,570) to plant under construction to exclude non-allowable items from rate base. The Commission has approved said adjustments in past rate cases and therefore believes that said adjustments should be approved in this case.

HURRICANE HUGO

Staff proposes an adjustment to accumulated depreciation to reduce rate base with the extraordinary retirement of plant damaged and retired due to Hurricane Hugo. The Commission finds this adjustment of ($964,032) to be appropriate under the circumstances and therefore approves said adjustment. Such adjustment is consistent with the adjustment covering amortization of retirements due to Hurricane Hugo discussed *supra*.

GTE DIRECTORIES, INC.

In addition, both the Staff and the Consumer Advocate propose an adjustment to telephone plant in service to reflect the rate base impact of including GTE Directories, Incorporated. Staff proposes an adjustment of $726,579, whereas the Consumer Advocate proposes an adjustment of $727,000. The Staff adjustment is hereby adopted. Further, the Staff proposes and we adopt an adjustment to materials and supplies of $799,731 and cash working capital of $133,660 to include the additional identifiable rate base impact of including GTE Directories, Incorporated.

The Company's rate base, as herein adjusted and determined by the Commission to be appropriate for the purposes of this proceeding is set forth as follows:

TABLE B
ORIGINAL COST RATE BASE
JULY 31, 1990

	$
Telecommunications Plant in Service	234,189,019
Accumulated Depreciation	<65,869,099>
Net Plant in Service	168,319,920
Telecommunications Plant under Construction	7,006,029
Property Held for Future Use	2,036
Materials and Supplies	2,949,643
Cash Working Capital	779,202
Accumulated Deferred Income Taxes	<28,489,983>
Customer's Deposits	<964,493>
TOTAL RATE BASE	149,602,354

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NOS. 13 AND 14

The evidence for these findings concerning the appropriate capital structure and embedded cost rate is found primarily in the testimony and exhibits presented by Company witness Austin, Consumer Advocate witness Legler, and Commission Staff witness Ellison. GTE does not maintain a capital structure for its South Carolina operations. The Company proposed that the capital structure of GTE South, Inc. be utilized to establish the overall return for GTE South's operations within South Carolina. The Commission Staff proposed the capital structure of GTE Domestic Telephone Operations, as of September 30, 1990 be utilized, as did the Consumer Advocate. Since the components of the capital structure found appropriate by the Commission in this case will be used to derive a fair rate of return for the Company, the Commission must weigh the various capital structures proposed by the parties in light of the criteria for determining a fair rate of return as set forth in the Supreme Court of the United States. In

Bluefield Water Works and Improvement Co. v. West Virginia Public Service Commission, 262 U.S. 679, 692, 693, 43 S.Ct. 675 (1923), the Court stated the applicable constitutional standard as follows:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but is has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. . . .

That standard was reaffirmed by the Court in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281 (1944), where the Court stated:

> . . .the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. . .

In the Permian Basin Area Rate Cases, 390 U.S. 474, 492, 88 S.Ct. 1344, 1373, 20 L.Ed.2d 312 (1968), the Court added that the results of a rate order must "fairly compensate investors for the risks they have assumed. . . ." This Commission has acknowledged these standards and has applied them in numerous cases in the past.

It is clear from these cases that the capital structure selected by the Commission in this proceeding must be one which accurately reflects financial risks presented by the utility which is the subject of regulation. Otherwise, the constitutional tests of reasonableness for a rate of return cannot be met. Moreover, the Commission is cognizant of its obligation pursuant to S.C. Code Ann. §58-9-570 (1976) to give "due consideration to. . .the capitalization of the telephone utility. . . ."

The Commission finds that the applicable legal principles and the substantial evidence of record require that the capital structure of the GTE domestic telephone operating companies be adopted for use in this case. This is totally consistent with the Commission's treatment of this issue in the Company's last rate order. The specific capital structure which the Commission adopts for use in this proceeding is depicted in the following table:

TABLE C

CAPITALIZATION - PER BOOKS

September 30, 1990

	Amount $	Ratio
Long-Term Debt	5,655,565	37.65%
Preferred Stock (Subject to Mandatory Redemption)	54,589	.36%
Preferred Stock (Not subject to Mandatory Redemption)	177,698	1.18%
Common Equity	9,133,076	60.81%
TOTAL	15,020,928	100.00%

The capitalization displayed in Table C, supra, reflects the actual capital structure of the GTE domestic telephone operating companies as of September 30, 1990, which the Commission finds fair and reasonable for ratemaking purposes in the instant proceeding. The capitalization and concomitant ratios have been utilized in the determination of a fair rate of return for the Company's operations.

EMBEDDED COST RATE

Long-Term Debt

The record indicates that, as of September 30, 1990, the embedded cost of long-term debt for the GTE Domestic Telops capital structure was 8.33%. The Commission considers that the embedded cost of long-term debt of 8.33% should be used for the determination of the cost of capital herein.

Preferred Stock

As of September 30, 1990, the embedded cost of preferred stock for the GTE domestic telephone operating companies was 6.39% subject to mandatory redemption and 6.22% not subject to mandatory redemption. In the determination of the overall rate of return herein, the Commission has used those cost rates.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 15

The evidence for these findings concerning the appropriate rate of return on equity are found primarily in the testimony of Company witness Vander Weide, Consumer Advocate witness Legler, and Staff witness Rhyne.

One of the principal issues in any ratemaking determination involves the proper earnings to be allowed on the common equity investment of the regulated utility. In this proceeding, the Commission was offered the expert testimony of witnesses relating to the fair and reasonable rate of return on common equity for the Company. These financial experts presented detailed explanations of a number of methodological approaches to the determination of the cost of equity capital.

The Commission's analysis of the evidence regarding the appropriate return on equity in this case must be guided by the constitutional principles set forth by the Supreme Court of the United States in Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, supra, and Federal Power Commission v. Hope Natural Gas Company, supra. These tests can be summarized as follows:

1. The allowed return on common equity should be the same as that earned on other investments of comparable risk.

2. Utilities have no constitutional right to profits realized by more speculative ventures.

3. The allowed return should be sufficient to maintain the utility's credit standing and enable it to raise necessary capital.

4. A reasonable return may vary over time reflecting changing economic conditions.

While the Commission adheres to no particular theory or methodology for the determination of a fair rate of return on common equity, it does test the various recommendations before it against these constitutional standards to determine the reasonableness of the approaches proposed by the various parties. With these legal standards in mind, the Commission is able to fulfill its function of engaging in a careful analysis of the economic and financial theories before it for application within a regulatory context.

The Commission heard the testimony of three (3) witnesses dealing with the cost of equity capital appropriate for GTSE operations in South Carolina. The Company presented testimony from Dr. James H. Vander Weide, Research Professor of Finance and Economics at Duke University. The Consumer Advocate presented the testimony of Dr. John B. Legler, Professor of Finance in the College of Business Administration at the University of Georgia. Dr. R. Glenn Rhyne, Director of the Commission Staff's Research Department testified on behalf of the Commission Staff.

Company witness Dr. Vander Weide utilized versions of the Discounted Cash Flow (DCF) approach and the risk premium approach to arrive at his final recommendations. Dr. Vander Weide recommended a cost of equity of 14.5%.

Dr. Legler, appearing on behalf of the Consumer Advocate, utilized various methodologies including the DCF method and the risk premium approach to obtain his recommendations. Dr. Legler used a cost of equity of 12.5%, based on a range of 12% to 13%, as an appropriate return on common equity for GTE's telecommunication operations within South Carolina.

Dr. Rhyne based his estimate of the cost of equity on his application of the DCF model and the Capital Asset Pricing Model (CAPM). Dr. Rhyne applied the models to a group of telephone utility companies which had a minimum level of non-regulated operations and contained risks appropriate for a utility providing regulated telecommunications services. Dr. Rhyne stated that he selected the sample as a proxy for GTE telecommunications operations in South Carolina because: "The cost of equity appropriate in this case should be a function of providing telephone services such as local service, intrastate access, interstate access, and toll. Ratepayers should not have to bear the risks that might result from any non-telephone and/or non-regulated investments." Tr. 4, Rhyne at 314. Dr. Rhyne's DCF approach produced a broad range which varied from 12.50% to 13.25% for the telecommunications industry. Tr., Vol. 4, Rhyne, p. 363. His CAPM analysis produced a best estimate for the Company in a range from 12.00% to 13.00%, with a best point estimate between 12.50% and 13.00%. Id. Dr. Rhyne's ultimate recommendation of the cost of common equity to for GTE's telephone operations within South Carolina was in a range from 12.50% to 13.00%. Id. at 364. His analysis incorporated the capital structure of the domestic telephone operating companies of GTE.

The testimony and exhibits of the financial witnesses for the Company, the Commission Staff, and the Consumer Advocate demonstrated an approach to their respective investigations within the parameters of the language of the United States Supreme Court in its decision in Federal Power Commission vs. Hope Natural Gas Co., supra. While the independent studies of each witness, either implicitly or explicitly, commenced with those standards, the respective methods employed produced quite different results, thereby presenting the Commission with a range between 12.0%, the lowest end of the range recommended in Dr. Legler's studies, and

14.50%, the recommendation of witness Vander Weide. In the final analysis, the Commission must determine the credibility and probative value of the testimony of the expert financial witnesses presented and the Commission must use its judgment in evaluating this evidence in regard to the cost of common equity, a matter which is within the expertise of the Commission.

The Commission must further appraise the opinions of the expert financial witnesses as to the expectations of investors or the opportunity costs of equity capital in conjunction with the tangible facts of the entire record of the proceeding, including the observable financial condition of the Company.

Furthermore, the Commission cannot determine the fair and reasonable return on common equity for the Company in isolation. Rather, the Commission must carefully consider a variety of relevant factors, including identifiable trends in the market relating to the costs of labor, materials and capital; comparisons of past earnings with present earnings and prospective earnings; the prices for which the Company's service must be rendered; the returns of other enterprises and the reasonable opportunities for investment therein; the financial policy and capital structure of the Company and its ability to attract capital; and the demonstrable competency and efficiency of the Company's management. The Commission must strike the balance among these complex and interrelated factors in the context of the record herein.

The Commission recognizes the legal principle and the practical necessity that the Company be allowed the opportunity to earn a fair rate of return to enable it to continue to meet its service obligations and to maintain its financial strength to provide for the attraction of capital. The present and perceivable perspective financial condition of the Company and the investor appraisal of that condition demonstrates to the Commission that the Company's cost of equity capital for its South Carolina intrastate telephone utility operations should be evaluated as somewhat lower than that postulated by the Company's witness herein.

In its determination of a fair and reasonable rate of return, the Commission maintains the ultimate responsibility of setting the rates to be charged for the utility services provided by the Company. The exercise of that responsibility involves the balancing of the interests of the consumer and the investor.

The Commission must gravely balance the interests of the consumer in regard to the price of utility service with the interests of the same consumer in regard to the reliability and adequacy of the intrastate telephone service. The Commission has maintained these interests paramount throughout this proceeding. The Commission's determinations of the Company's revenue requirements and of the proper allocation of these revenues within the approved rate structure embodied in this Order reflect fairly and equitably the interests of those consumers.

Upon a thorough review of the conclusions reached by each financial and economic witness in this proceeding, as well as upon our consideration of the full evidence in the record before us, the Commission has determined that the additional revenues of

$10,695,955 produced by the proposed rate schedules for the Company's intrastate operations, which would generate a rate of return on equity of 14.5%, based on adjusted test year figures, are excessive and unreasonable. That return on common equity and the associated revenues cannot be supported by the evidence in this proceeding.

There are various factors that contribute to the range of recommendations of the witnesses. One major difference in the Discounted Cash Flow analysis of the witnesses involves the issue of flotation costs. Dr. Vander Weide has incorporated a 5% flotation cost adjustment in his estimates. This Commission has consistently considered the need for a flotation cost adjustment on a case by case basis. Based on the Commission's precedents, clearly there is no need for an adjustment in this case. Both Dr. Legler and Dr. Rhyne concluded that such an adjustment is inappropriate in this case. The Company has not demonstrated that it intends to have a public offering that would incur such expense, and further, has not demonstrated that an issue would benefit the South Carolina ratepayers. Indeed, the Company has gone so far as to state on the record that an announced equity infusion from the parent has been eliminated from the Company's plans. Tr. 2, Austin at 79-80.

Another difference in the cost of equity estimate of the witnesses results from Dr. Vander Weide's "cellular phenomenon" adjustment. Since GTE South's stock is not publicly traded, it is necessary to use a proxy or surrogate group of companies in estimating the cost of equity to GTE South. Dr. Vander Weide used the former Bell Regional Holding Companies as one such proxy in his analysis. Dr. Vander Weide believes that the stock prices of former Bell Regional Holding Companies are currently higher than they would be in the absence of the cellular activities. Essentially, he argues that the prices are inflated by cellular activities, but these activities have not and are not incorporated within the earnings projections that he uses within his discounted cash flow analysis. Dr. Vander Weide uses the Institutional Brokers Estimate System (IBES) summary of analyst's five year earnings projections to estimate the expected growth rate in dividends per share that he incorporates in the Discounted Cash Flow analysis.

It is not clear to what extent the market values the cellular activities of the sample of companies and the extent to which such valuation has impacted market price. Dr. Vander Weide assumes that the market would value cellular investments to a similar extent as the Companies seeking to acquire and develop such activities. Such an assumption appears to be unfounded. The methodology and the assumption employed by Dr. Vander Weide in his analysis of the cellular phenomenon leads to returns which would significantly overstate the impact of any such adjustment. Dr. Vander Weide has also failed to demonstrate that such an adjustment is required at all. The strength of the regulated telephone operation of the sample of companies provides much of the market value claimed by Dr. Vander Weide to result from cellular activities.

During his appearance, Dr. Vander Weide corrected his DCF analysis which adjusted for the cellular component. In his prefiled testimony, Dr. Vander Weide failed to properly account for stock splits which had taken place for two of the Bell Regional Holding Companies. These corrections resulted in a substantial downward revision in Dr. Vander Weide's estimates. Dr. Vander Weide dismissed the importance of these corrections and maintained his original recommendation. In conclusion, Dr. Vander Weide's cellular phenomenon adjustment serves only to overstate the appropriate cost of equity estimate for GTE operations within South Carolina.

Dr. Vander Weide also employed a cluster analysis to select a proxy sample of companies to estimate the cost of equity. He selected a sample from approximately 7,000 firms included in standard and poor's Compustat Services data base. The risk indicia he used to pick the sample included the availability of operating income, the magnitude of sales growth, the ratio of cash flow to assets, the debt ratio, and the level or size of assets. While cluster analysis is a familiar statistical technique, its application to a cost of equity analysis can provide unreasonable outcomes when administered in an inappropriate manner. The sample of companies selected by Dr. Vander Weide cluster analysis process does not reflect a similar or appropriate level of risk for a regulated telecommunication firm. In fact, the great majority of companies included within the sample have only non-regulated operations. Based on this sample, Dr. Vander Weide has recommended a cost of equity based on a group of non-telephone and largely non-regulated firms. This recommendation is clearly inappropriate.

Based on these considerations: (1) the erroneous inclusion of an issuance cost adjustment; (2) an erroneous attempt to adjust the DCF to allow for a so-called cellular phenomenon, (3) the inappropriate cluster sample selected; and (4) the overstatement of the market's expected risk premium within the risk premium analysis, the Commission believes the Company's requested return on common equity is excessive and should be rejected.

It, therefore, becomes the Commission's responsibility to set a fair and reasonable rate of return on common equity from which can be derived the lawful rates for the Company for its South Carolina intrastate telephone operations. This responsibility must be discharged in accordance with statutory and judicial standards and based upon the numerous factors identified herein, and applied in accord with the informed judgment of the Commission.

Based on the information presented within the context of this rate proceeding and specifically the rate of return studies, the Commission finds that the value of 12.50% is the best point estimate of the Company's fair rate of return on equity. Incorporating this number as the allowable rate of return on common equity results in an overall rate of return of 10.83%.

The rate of return on common equity herein found fair and reasonable falls within the range produced by the studies of Dr. Rhyne and Dr. Legler.

The Commission considers the results reached by these studies to have incorporated effectively the expectations of the potential equity investor through the estimate of the relevant risk of investment in the Company's equity relative to the market as a whole. The relevant risk of the Company is impacted by such factors as economic and financial conditions, inflationary expectations, competition, industry characteristics and the fundamental characteristics of the firm. The Commission concludes from the context of these studies that the point estimate of 12.50% more closely reflects the current level of risk of the Company, including the current conditions within the telecommunications industry, and, therefore, appropriately incorporates investors existing expectations. This rate will provide the Company with an opportunity for a return commensurate with the return that equity owners could expect to obtain in other enterprises having corresponding risks.

The Commission considers the value of 12.50% to represent a reasonable expectation for the equity owner, and, therefore, consistent with the standards in the Hope decision. A rate of return on rate base found fair and reasonable is sufficient to protect the financial integrity of the Company, to preserve the property of the investor, and to permit the Company to continue to provide reliable services to present and future customers at reasonable rates.

In arriving at a rate of return herein, the Commission is primarily concerned only with the return to be earned on the common equity allocated to that portion of the Company's operations subject to the Commission's jurisdiction in this proceeding. The Commission has made its findings based on the jurisdictional South Carolina intrastate operations of the Company.

An important function of ratemaking is the determination of the overall rate of return which the utility should be granted. This Commission has utilized the following definitions of "rate of return" in previous decisions, and continues to do so in this proceeding:

> For regulatory purposes, the rate of return is the amount of money earned by a regulated company, over and above operating costs, expressed as a percentage of the rate base. In other words, the rate of return includes interest on long-term debt, dividends on preferred stock, the earnings on common stock and surplus. As Garfield and Lovejoy have put it "the return is that money earned from operations which is available for distribution among the various classes of contributors of money capital. In the case of common stockholders, part of their share may be retained to surplus."
>
> Phillips, The Economics of Regulation, pp. 260-261 (1969).

The amount of revenue permitted to be earned by the Company through its rate structure depends upon the rate base and the allowed rate of return on the rate base. As previously discussed, the primary issue between the regulated utility and regulatory body most frequently involves the determination of a reasonable return on common equity, since the other components of the overall rate of return, *i.e.*, dividends on preferred stock and cost of debt, are fixed as of September 30, 1990, the appropriate capital structure used herein. Although the determination of the return on common equity provides the necessary component from which the rate of return on rate base can be derived, the overall rate of return, as set by this Commission, must be fair and reasonable.

The United States Supreme Court's landmark decision in Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, supra, also delineated general guidelines for determining the fair rate of return in utility regulation. In the Bluefield decision, the Court stated:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertaking which are attended by corresponding risk and uncertainties; but it has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business generally.

262 U.S. at 692-693.

During the subsequent year, the Supreme Court refined its appraisal of regulatory precepts. In its frequently cited Hope decision, supra, the Court restated its view:

> We held in Federal Power Commission v. Natural Pipeline Gas Co....that the Commission was not bound to the use of any single formula or combination of formulae in determining its rates. Its ratemaking function, moreover involves the making of 'pragmatic adjustments' (citation omitted).... Under the statutory standard of 'just and reasonable' it is the result reached, not the

> method employed which is controlling (Citations omitted)....
>
> The ratemaking process under the Act, i.e., the fixing of 'just and reasonable' rates involves a balancing of the investor and the consumer interests. Thus we stated in the Natural Gas Pipeline Co. case, that regulation does not insure that the business shall produce net revenues. (Citations omitted)
>
> But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. (Citation omitted). By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.
>
> 320 U.S. at 602-603.

The vitality of these decisions has not been eroded, as indicated by the language of the more recent decision of the Supreme Court in IN RE: Permian Basin Area Rate Cases, 390 U.S. 747 (1968). This Commission has consistently operated within the guidelines set forth in the Hope decision.

The Commission has found that the capitalization ratios as of September 30, 1990, as adjusted, are appropriate and should be used in the instant proceeding. The Commission has likewise found that the respective embedded cost rates for long-term debt of 8.33% and for preferred stock of 6.39% subject to mandatory redemption and 6.22% not subject to mandatory redemption, should be utilized in the determination of a fair rate of return. For the purposes of this proceeding, the Commission finds the proper cost rate for the Company's common equity capital to be 12.50%.

Using these findings, the overall rate of return on rate base for the Company's South Carolina intrastate operations may be derived as computed in the following table:

TABLE D
OVERALL RATE OF RETURN

	RATIO %	COST %	WEIGHTED COST %
Long Term Debt	37.65	8.33	3.14
Preferred Stock (Subject to Mandatory Redemption)	.36	6.39	.02
Preferred Stock (Not Subject to Mandatory Redemption)	1.18	6.22	.07
Common Equity	60.81	12.50	7.60
	100.00%		10.83%

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 16

Evidence on incentive regulation is found in the testimony of Company witness Farmer, Consumer Advocate witnesses Effron and Ileo, AT&T witness Dowdy, and Commission Staff witness Walsh. The Commission hereby holds the matter of the Company's proposed incentive regulation plan in abeyance until further Order of the Commission.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 17

Evidence for this finding concerning rate design, rate schedules and service regulations is found in the testimony and exhibits of Company witnesses Klassen, Kunkle, Turner, and Wellemeyer, Consumer Advocate witness Ileo, and Commission Staff witness McDaniel. The revenue requirements of the Company having been determined, the Commission is also concerned with the determination of the specific rates and the development of the rate structure that will yield the required revenues. It is generally accepted that proper utility regulation requires the exercise of control over the rate structure to insure that equitable treatment is afforded each class of customer.

The Commission has traditionally exercised its statutory responsibility to provide "just and reasonable" rates, pursuant to S.C. Code, §58-9-570 (1976) by the recognition and implementation of the objective to provide telephone utilities a fair opportunity to earn a reasonable return which produces the allowed revenue requirement in a manner which equitably apportions the revenue responsibility among the beneficiaries of the utility's service. In discharging that responsibility, the Commission has traditionally identified three pertinent ratemaking criteria:

a. The revenue requirement or financial-need objective, which take the form of a fair-return standard with respect to private utility companies;

b. The fair-cost apportionment objective, which invokes the principle that the burden of meeting the total requirement must be distributed fairly among the beneficiaries of the service;

c. The optimum-use or consumer rationing objective under which rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between costs incurred and benefits received.

Bonbright, Principles of Public Utility Ratemaking (1961), p. 292.

These criteria have been observed by this Commission in recent proceedings and again are utilized in this matter.

The record of this proceeding reveals that the Company's objectives in formulating the pricing proposals in this case were to 1) achieve more efficient utilization of the existing and future facilities, 2) provide a more equitable pricing structure, 3) maintain universal service, 4) assure marketability of service, 5) recognize cost of service and value of service considerations, and 6) assure uniformity of rates.

The Commission recognizes both the inherent limitations and benefits of analyses based on cost as well as upon the value of telecommunications services. Various costing methodologies have been applied to many of the rates and charges in the distribution of revenues proposed by the Company in this matter.

The Commission's analysis of the design and effect of the proposed rates and charges must begin and end with a recognition and reconciliation of the Commission's stated objectives to meet the reasonable revenue requirements fairly and to consider the economic equation of costs and benefits for the subscriber.

CALL TRACING

The Company proposes to implement a charge of $40.00 associated with the tracing of harassing calls. The Commission believes that the Company should be compensated for this service and, therefore, approves this proposal.

BASIC EXCHANGE SERVICE

The Company proposes to eliminate zone charges. Staff agrees with this proposal. The Consumer Advocate, however, recommends the transition to elimination of zone charges. The Commission believes that it is in the best interest of the consumers to simply eliminate the charges, therefore, the original Company proposal in this regard is adopted. The Company proposes to reduce the free call allowance from five calls per month to two calls per month to directory assistance. The Staff agrees with this recommendation. The Consumer Advocate recommends an increase in the per call charge for this service, however, the Commission is of the opinion that the number of free calls simply be reduced from five to two without an accompanying increase in the per call charge for the service.

With regard to operator-assisted local calls, the Company proposes to increase the charges as follows:

	PRESENT	PROPOSED	INCREASE
CREDIT CARD	$0.30	$1.00	$0.70
STATION-TO-STATION	$0.70	$1.25	$0.55
PERSON TO PERSON	$1.70	$2.50	$0.80

Since this proposed increase is unopposed by any party, the Commission approves the proposed increases.

With regard to verification and emergency interrupt, the

Company proposes to increase its rate as follows:

	PRESENT	PROPOSED	INCREASE
VERIFICATION	$0.35	$0.70	$0.35
EMERGENCY INTERRUPT	$0.75	$0.90	$0.15

Verification service allows a customer with a legitimate call problem to ask an operator to verify the status of a called line. If conversation is determined to exist on the line, the charges are applied. Upon verification of the conversation on the line, should a customer request a conversation in progress to be interrupted in an emergency situation, the customer will incur an additional incremental charge equivalent to the interrupt charge. The Commission finds that the proposed increase in these services is warranted and that further, no opposition is present to the proposal. With regard to service charges, the Company proposes to increase the premises visit-initial charge on both business and residential visits from $13.75 to $37.00. It appears to this Commission that the increase as proposed is excessive and that a rate of $25.00 is just and reasonable, therefore, the Commission approves an increase of the premises visit-initial visit charge from $13.75 to $25.00.

The Company proposes combining the current secondary and record service order charges and renaming the charge Network Access Change Charge (NACC). For residential customers, this charge is proposed to be $10.00 per request. For business customers, this charge is proposed to be $14.00 per request. The Commission finds good cause for this proposal and, therefore, approves it.

The Company also proposes repricing the relocation of drop and protector charges based on fifteen minute increments, instead of the currently approved thirty minute increments. The proposed rates for this service are $39.00 for the first fifteen minute increment and $8.50 for each additional fifteen minute increment. The Commission finds these charges to be just and reasonable, and therefore, adopts same.

The Company proposes an increase in the return check charge to $15.00. This is the same as mandated by state law and this is, therefore, approved.

With regard to directory listings, the Company has proposed an increase in the rate charged the customer for a non-published telephone number from $1.75 to $2.30. Although the Consumer Advocate has recommended a greater increase for a said directory listing or a lack thereof, the Commission feels that $2.30 is appropriate for this service.

With regard to telephone answering service facilities, the Company proposes an increase in secretarial line mileage to the rate of $5.00 per quarter mile from the present $1.95 per quarter mile. The Commission believes that this increase is reasonable under the circumstances and, therefore, approves said increase.

FOREIGN EXCHANGE AND FOREIGN CENTRAL OFFICE SERVICE

The Company proposes repricing foreign exchange service transport at proposed special access rates. This is hereby approved. Further, the Company has proposed repricing foreign central office service from the present rate of $6.50 for the first mile and $1.30 for each additional quarter mile to $9.46 per mile.

This is a reasonable proposal and is therefore approved.

MISCELLANEOUS SERVICE ARRANGEMENT

The Company has proposed increasing mileage rates for off premises extensions. The present rate for off premises extensions is $1.95 per quarter mile, and with ten or more extensions, the rate is 65¢ per quarter mile. The Company proposes the institution of a uniform rate of $5.00 per quarter mile, regardless of the number of extensions. The Commission believes that this is a reasonable charge and, therefore, adopts same.

With regard to the Company's proposal to increase rates for Smart Call single feature (call-forwarding and eight number speed calling) and to eliminate non-recurring feature implementation charges, the Commission is of the opinion that the Company's proposal is correct, even though the Consumer Advocate has recommended a greater increase for the Smart Call features. In addition, the Commission approves the Company's proposal to reduce the engineering charge for direct inward dial service and to eliminate the charge for temporary suspension of service.

With regard to touch-tone calling service, the Staff has recommended that the Commission consider the elimination of touch calling service charges. The Consumer Advocate has recommended that these charges be increased, whereas the Company has not proposed any increases for this charge. The Commission is of the opinion that Staff's recommendation with regard to touch calling service charges is reasonable and appropriate, and said recommendation is adopted.

INTRALATA TOLL

The Company has proposed to use its own special access services tariffs for the pricing of intraLATA private line and channel services and foreign exchange services. The Company would be required to withdraw its participation in the intraLATA toll poll for the settlement on these services. The result of this proposal would be that the private line and foreign exchange customers will pay the same charges as interexchange carriers for special access service. The Company is proposing to convert its private line and foreign exchange rate structure to the same rate structure used for Special Access used by the Interexchange Carriers. This proposal would allow the Company to have one tariff for functionally equivalent services. For intraexchange private line and foreign exchange customers, the Company is proposing to use the same rates as contained in its proposed special access service tariff, except for the voice grade Special Access Line (SAL). Therefore, with this exception, the intraexchange and interexchange private line and foreign customers will also be paying the same rates as any interexchange carrier using special access services. Even though the rates proposed by the Company will increase revenues derived through private line and foreign exchange services, the net effect of this proposal, because of the loss in toll settlements, would be a reduction in the Company's revenues by $1,667,091. Additionally, as a result of this proposal, the customers of interexchange private line and foreign exchange services could receive multiple billings if the services provided by GTE in conjunction with other local exchange companies. However, upon consideration of the matter, the Commission is of the opinion that the conversion to a situation where the private line and foreign exchange customers will pay the same charges as interexchange carriers for special access service is appropriate and desirable. Therefore, the Commission approves this proposal. Additionally, the Company proposed the conversion to take place by July 1, 1991. In the interim, from the date of the Order, and effective date of the conversion, the Company is required to notify existing private line customers of the specific rate of this change, and where appropriate, assist the customer with reviewing alternative services if the customer should desire such assistance.

INTERLATA TOLL REVENUE

The Company proposes to restructure and to reduce Switched Access charges. The combined elements will be placed into new local switching elements. LS1 and LS2 would be priced at the same level under this proposal. The Company also proposes to increase rates for Special Access Services. Further, the Company proposes to restructure Carrier Common Line Charge (CCLC) to a flat access line rate. To restructure and combine the elements into new local switching elements and pricing LS1 and LS2 at the same level is reasonable, and the Commission therefore, approves same. The rate structure of the Switched Access charges should incorporate the Company's proposals and should be revenue neutral. The Company proposal to reduce its Switched Access charges to its interstate level would require substantial shift of the Company revenue requirement to local basic exchange service. In light of the consumer impact of this proposal, the Commission denies the Company proposal to reduce its Switched Access rates and charges. The Commission approves the proposal to increase the rates for the Special Access Charges. With regard to the proposal to restructure the CCLC to a flat per access line rate, the Commission denies the proposal for two reasons. First, other local exchange companies are handling the matter as GTE is under its present system. Second, a change in restructuring the CCLC to a flat per access line rate should be considered for all local exchange carriers at the same time in the hearing which is forthcoming before of the Commission. For these reasons this proposal is denied.

RATES

The Commission acknowledges the complexity of the task of setting just and reasonable rates. The relevant principles characterized in the testimony and the exhibits in the record in this proceeding and those traditionally employed by this Commission have been fully considered in reaching its determination. The Commission has endeavored to annualize the Company's proposed rates and incorporate our finding of the proper increase in revenues in a derivation of equitable, lawful and reasonable rates.

The Company's Application incorporated proposed rates schedules which would generate the amount of additional revenue requested by the Company. The Commission has determined that the requested amount should be reduced.

In light of the evidence in the record before us and based upon our evaluation of the applicability of the principles of ratemaking, the Commission is of the opinion and so finds, that fair and reasonable rates and charges for local exchange service are as set forth in Appendix A of this Order, effective for service rendered on or after May 29, 1991. The Company will herein be required to file for approval within thirty (30) days of the date of this Order revised schedules and tariffs consistent with the terms of this Order, which incorporate the revenue reduction determined in this Order to be appropriate.

The following table represents the total revenue effect, as adjusted, of the rates and charges proposed by the Company and the rates and charges approved herein by the Commission.

TABLE E

	$
TRACING & HARASSING CALLS	7,800
LOCAL SERVICE EXCL BASIC SERVICE	189,036
SERVICE CHARGES	221,192
NONPUBLISHED NUMBERS	104,718
TELEPHONE ANSWERING	14,713
FX	13,510
MISC SVC ARRANGEMENTS	327,522
PRIVATE LINE SVC	380,623
SUBTOTAL	1,259,114
INTRALATA PRIVATE LINE	<1,667,091>
INTERLATA	< 422,897>
BASIC LOCAL RATES	5,189,769
NET INCREASE	4,358,895

IT IS THEREFORE ORDERED.

1. That the proposed rates and charges filed by the Company on November 30, 1990 are unreasonable and improper and are hereby denied.

2. That the Company file with the Commission for approval within thirty (30) days of the date of this Order tariffs in accordance with the findings contained herein.

3. That the rates and charges herein approved shall take effect on and after May 29, 1991.

4. That the Company continue to file quarterly reports showing rate of return, rates of return on common equity and rate base filed within sixty (60) days from the end of the calendar quarter.

5. That the matter of the Company's proposed incentive regulation plan shall be held in abeyance until further Order of the Commission.

6. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Marjorie Amos-Frazier
Chairman

ATTEST:

Charles W. Ballentine
Executive Director

(SEAL)

GTE SOUTH, INC.

APPROVED RATES

	RATE GROUP 1	RATE GROUP 2
BUSINESS		
Dial Tone Access	$21.04	$21.04
Unlimited Usage:		
1 Party	$ 8.70	$12.30
Manual Access	$ 8.70	$12.30
Automatic Access:		
1st 10 Lines	$32.26	$38.40
Addl. Lines	$20.48	$25.09
Semi-Public	$38.91	$45.57
RESIDENCE		
Dial Tone Access	$10.24	$10.24
Unlimited Usage:		
1 Party	$ 3.44	$ 5.72
Manual Access	$13.31	$15.87
ROTARY LINE		
BUSINESS:		
1 Party	$20.43	$22.94
Manual Access	$20.43	$22.94
RESIDENCE:		
1 Party	$ 8.70	$ 9.92
Manual Access	$ 8.70	$ 9.92

USAGE SENSITIVE		
BUSINESS:		
1 Party	$21.04	$21.04
Manual	$21.04	$21.04
Automatic	$21.04	$21.04
RESIDENCE:		
1 Party	$10.24	$10.24
Manual	$10.24	$10.24
PUBLIC TELEPHONE ACCESS		
Measured	$21.04	$21.04
FOREIGN EXCHANGE		
BUSINESS:		
Dial Tone Access	$21.04	$21.04
Unlimited Usage:		
1 Party	$ 8.70	$12.30
Manual Access	$ 8.70	$12.30
Automatic Access:		
1st 10 Lines	$32.26	$38.40
Addl. Lines	$20.48	$25.09
RESIDENCE:		
Dial Tone Access	$10.24	$10.24
Unlimited Usage:		
1 Party	$ 3.44	$ 5.72
Manual Access	$13.31	$15.87

TEMPORARY SUSPENSION		
BUSINESS:		
Dial Tone Access	$21.04	$21.04
Unlimited Usage:		
1 Party	$ 8.70	$12.30
Manual Access	$ 8.70	$12.30
Automatic Access:		
1st 10 Lines	$32.26	$38.40
Addl. Lines	$20.48	$25.09
RESIDENCE:		
Dial Tone Access	$10.24	$10.24
Unlimited Usage:		
1 Party	$ 3.44	$ 5.72
Manual Access	$13.31	$15.87
SHARED TENANT		
Measured Rate	$21.04	$21.04